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**FINANCING IMPLICATIONS OF MINERAL DEVELOPMENT AGREEMENTS:
SOME NOTES ON RECENT MINERAL AGREEMENTS IN SOUTH AMERICA**

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FINANCING IMPLICATIONS OF MINERAL DEVELOPMENT AGREEMENTS: SOME NOTES ON RECENT

MINERAL AGREEMENTS IN SOUTH AMERICA

I) Introduction: The impact of the legal regime for financing mineral development

The legal regime governing mineral development projects is of essential importance for the financing arrangement, i.e. the negotiation, the structure and finally the implementation of the financing mechanism for a mining project. The legal regime for a mining investment determines primarily the amount of funds that are available from the project's future cash flow to repay loans, share profits between the partners, allow repatriation of depreciation, dividends and capital to project sponsors. Thereby, it defines the distribution of income between the project's investors (sponsors), financiers and the government. For example, the government's share will in all likelihood consist of income taxes, tempered by extensive accelerated depreciation/amortization rules, of additional profits taxes based on income exceeding a specified internal rate of return, on levies on the value of production (royalties; export taxes; minerals levies etc.), on taxes on dividends distributed and on income shared on the basis of free, carried or fully paid-up government equity in a project. Production-sharing is another feature influencing the amount of cash flow available, and in fact resembles, if calculated as a fixed percentage, a royalty.

In addition, the legal regime of a mining project will contain provisions that are essential for a lender (and an investor) who have a vital concern to obtain a return (based on interest or based on profit) from the financing provided. For example, there will be provisions concerning the availability of foreign exchange to service debt and allow repatriation up to a certain level of dividends; there will be provisions regulating the foreign exchange component of sales proceeds, with priority for debt service and in some agreements there is a special foreign trust account set up to receive sales proceeds, in particular from long-term sales contracts vital for mine financing; the amounts held in the account are administered by a trustee in accordance with contractual instructions and distributed according to the guidelines set up, in general with priority to servicing debt, followed by paying out to the investor/sponsor what is due to him under the relevant contracts. (Suratgar, 1982; Stockmayer and Suratgar, in: UN/DSE, 1982; Mc Cormick, 1983; Stockmayer, forthcoming 1984)

Provisions in mining contracts sometimes address quite specifically questions of financing. For example, contracts may stipulate that a certain debt/equity ratio not be exceeded (e.g. 75:25), that payments received by project investors as interests on shareholder loans are considered as taxable income if a specified debt/equity ratio is exceeded. Contracts often distribute responsibility for financing, mainly on the mining project operator and impose general obligations on him, such as to seek financing at competitive terms. Shareholder loans are an important part of the financing package and they may be tied to long-term purchase commitments and repaid out of proceeds from long-term purchase contracts. Clearly, shareholder loans have to be scrutinized carefully so as to avoid channeling away of untaxed profits. The credit exposure of both government, project investors/sponsors and participating state enterprises has become an important issue for negotiations, where the obligation to provide loan guarantees for expenditures envisaged, but in particular for cost overruns and unexpected shortfall of revenues required for debt service has to be distributed between government, state enterprises and project sponsors. (Cf. Stewart Mc Gill, 1983)

As home country taxation may affect the cash flow available, contracts frequently provide for an obligation of both partners to promote the conclusion of a favorable double-taxation treaty or to adapt the agreement in case of a change in the home country's tax rules so as to allow the project sponsor to obtain maximum tax credit at home without detriment to the host state.

Quite apart from contractual or regulatory provisions addressed directly to financing, the legal regime of a mining project is of great concern to lenders, as its provisions, the management and control structure, the financial system and the legal status established thereby will be decisive for the investment project's ability to perform satisfactorily and thereby to repay loans and provide return on investment. While some clauses in the agreement, i.e. the provisions stabilizing the fiscal regime constituted against subsequent legislation or the provisions setting up a procedure of arbitration to settle disputes affect the stability of the agreement directly, other stipulations, i.e. renegotiation clauses, the system of joint ownership, of management and control established, are decisive for the ability of the project to perform. Lenders tend for these reasons increasingly to scrutinize not only the provisions of an agreement directly relevant for the availability of funds for repayment of loans, but also the overall character, status, fairness and flexibility of a mineral development agreement. Their interest will be served best if the agreement, generally envisaged to govern relations for several decades, is likely to stand the test of time and change. Contracts that may look very beneficial to investors achieved at a time of low bargaining power, skill, information and experience of government may in the longer run be counterproductive and be likely to provoke pressures for change, renegotiated or unilaterally imposed, that may be perilous to the fine fabric of a complex arrangements coordinating interests and performances by investors, financing institutions, long-term purchasers and government.

The legal regime of a mining project consists, depending on the legal tradition in a specific developing country, of legislative and regulatory

elements on one side and contractual elements on the other side. For example, the country's mining, investment, tax, company, customs, foreign exchange, labor and environmental law may provide the legislative and regulatory framework, and they may often provide rules that are directly applicable (i.e. income tax law; duration of mining titles; mines safety regulations), while contractual elements may specify the applicability of general legal principles, adjust the general legal regime to the specific requirements of the project at issue and reflect the long and strenuous bargaining process to achieve an agreement on the distribution of revenues, of risks, of ownership, capital contributions and management powers between the participants. On the side of the contracts, one can find an investment contract between the government and the investor governing the grant of investment incentives, a mining agreement with the Ministry of Mines determining the applicability of the mining law, the content, scope and duration of mining titles, but also obligations concerning environmental protection, economic development and several components of the project's fiscal regime. If the state enterprise plays an important role, often major issues of control, management, ownership, marketing, revenue-sharing and risk-capital are addressed in a specific agreement with the state mining enterprise. More recently, as state enterprises have become project sponsors themselves, the foreign investor's role is transformed to contractor (or contractor/joint venture investor) supplying management, technical assistance and financing to the state enterprise. Financing arrangements are sometimes handled exclusively in agreements between sponsors/investors and lenders, but often a network of agreements involving project sponsors, state enterprise, government authorities (i.e. Mining Ministry, Central Bank; Ministry of Finance), multilateral and bilateral public financing institutions, export financing agencies and long-term purchasers of projected mineral output is necessary (cf. Suratgar, Stockmayer; Mc Gill).

In the following, recent developments in mining and investment legislation and mining agreements will be discussed and three specific agreements of considerable interest - in Colombia, Chile and Guyana - will be analysed in more detail.

II) Recent Developments in Mining/Investment Legislation and Mineral Development Contracts

The period from 1965-1980 was characterized by events reflecting a strong assertion of permanent sovereignty over natural resources by developing countries, by large-scale nationalizations of minerals extraction, by renegotiation of existing arrangements, by the coming into being of state enterprises and by numerous commodities producer associations. The 1980s seem to highlight problems of investment, i.e. the successful combination of capital, technology and managerial capacity, and the problems of declining demand, both necessary to transform reserves into working projects generating benefits for national economic development. The recession in developed market economies, leading to the present crisis of the world's mining industry, does not facilitate this task. Persistent low prices, high inflation rates and high investment costs result in low profit margins or operating losses; ability and willingness to invest in exploration and mine development are substantially curtailed. The situation of projects in developing countries is particularly aggravated. Very high costs for new projects, in particular for substantial infrastructural facilities and political risk perception on the side of companies and financing institutions make it very difficult to develop new projects. Most large-scale mining projects developed in the seventies have not fulfilled the financial expectations of governments, investors and lenders, and several (e.g. Selebi Phikwe in Botswana, EXMIBAL in Guatemala) have resulted in large losses and in continuous debt restructuring. Many large-scale projects have been scaled down or abandoned altogether (e.g. Tenke Fungurume in Zaire). Competition between many potentially economic deposits increases substantially the time between discovery of most deposits and their commercial development. New investment takes place mostly in the case of high-grade, smaller-scale projects or in projects with significant by-products (e.g. gold), in projects without substantial infrastructural requirements and generally in countries benefitting from favourable risk assessment or in projects benefitting from public subsidy (e.g. the Sohar copper project in Oman). Closures of existing mines and processing facilities are frequent.

It is not surprising that the large financial resources necessary for project development are very difficult to obtain. The high debt burden of most producer countries and the frequency of present debt rescheduling has made public and commercial financing institutions more wary to commit funds to risky mining projects, with ever less assurance of later sales at the price necessary to repay loans. Project financing, the solution of the end-1970s, is getting more difficult, as at present few new projects promise on their own strength sufficient returns for adequate repayment and risk coverage; if project financing is possible, it is undertaken on the strictest terms, both for countries and investors, and tough completion guarantees are attached, acting as an additional investment deterrent. New projects almost always include extensive supplier credits and non-commercial concessional public finance.

Companies which have traditionally been willing to invest their own risk capital have turned to carrying out exploration on a service-contract basis, particularly in petroleum producer countries. Countries intent on having discovered deposits developed are finding that companies ready to sell their services or equipment (management, technical assistance, turnkey projects) abound, but that it is exceedingly difficult to get these suppliers to commit themselves by taking a substantial equity stake in the project. The substitution of equity financing by external loans in the 1970s continues and external financing requires guarantees that not all countries and state enterprises are able, or considered capable, of providing.

Oil companies, considered a new and promising source of financing at the end of the 70s, are more wary about investment in non-fuel minerals, as the large-scale entry of the oil majors has so far produced only losses (for example, EXXON Minerals has so far incurred losses of over US\$500 million). Oil-producing countries were also expected to become heavily involved in hard minerals; however, they had to reduce their role as real oil income is falling short of optimistic projections. The comparably high prices in some years in the past and concerns over security of supply have stimulated large flows of

private and public funds into mineral exploration and mine development; as a result, there is oversupply in most minerals (bauxite, nickel, uranium, iron ore, copper and others) and new projects compete with each other for financing funds and purchase commitments.

The choices for Governments desirous of developing national resources are difficult. They can choose to postpone mineral development, except for minerals needed for domestic consumption, until a more propitious situation should come about. They can also adopt the strategy of establishing a vigorous state sector, financed by public funds which could be the main vehicle for phased development of a national mining industry. This is the way which has been chosen, for example, by India and it might be available to countries with large indigenous technological, managerial and financial resources and a domestic market of sufficient size. Governments may also choose the policy of energetically encouraging investment. In that case, it is essential to prepare the groundwork for improved government policies, expressed in mineral development and investment legislation and in agreements. In a number of countries, legal instruments for mineral development do not yet achieve the optimum possible, i.e. attraction of investment, fairness of terms and a significant contribution to national economic development. Accordingly, there is room for considerable improvement which could become most effective if and when the macro-economic outlook for the world's mining industries improves. The many instances of mineral investment by developing countries in other developing countries recently or by centrally planned economies (cf infra) may portend more substantial involvement in the future.

. Legislation addressing investment, in particular foreign investment, has been a characteristic feature of the last decade. In the early 70s, investment legislation was predominantly directed to screening, monitoring and restricting foreign investment; more recently, and in particular at present, the emphasis seems, on observing world-wide trends, to have shifted from restriction to, albeit selective and controlled, promotion and encouragement. This trend reflects changed economic conditions: investment, particularly in

natural resources, has slowed down substantially; also, in a number of countries, new policies are a response to experience with parastatals gained subsequent to nationalization.

. Mining legislation is the method used by Governments to regulate mining activities proper. Traditionally, the main function of mining laws focused on the relationship between mining and land ownership and on state regulation of mining activities. The mining law governed the issue, the administration and the cancellation of mining titles; it organized government agencies and their supervisory powers; and it covered settlement of disputes between competing claims. Over the last decade, new mining laws have been enacted in many developing countries and are being updated. The policies underlying recent mining legislation is reflective of the priorities and national strategies pursued by the respective Government. A common denominator seems in many instances to have been the need perceived to replace pre-independence legislation. Another feature of many mining laws in the late 60s and early 70s has been to express an emphasis on the state sector, though this emphasis has been less pronounced in recent years, as illustrated in the greater emphasis on private investment.

. In the case of large-scale projects, contract negotiations between the Government and the prospective investor are usual. While legal systems influenced by French law regulate investment agreements (convention d'etablissement) in some detail, countries influenced by British law tend to negotiate ad hoc agreements, sometimes embodied in "special licences". Experience has shown that it might be preferable for both partners if the authority and the procedure for negotiating and concluding agreements with investors, including the scope of such agreements, were clearly spelled out in the mining law. Also, the bargaining position of a Government is clearly enhanced if its laws provide a clear framework, a set of policy objectives and legal predictability for individual project contracts. Lastly, one can observe a trend towards standardizing mechanisms negotiated in contracts which have proved useful, either by incorporating them into model agreements or into generally applicable legislation. This development strengthens the hand of

Governments and reduces the often very heavy burden on government resources required by detailed and protracted negotiations. Also, the issue of mining rights is increasingly being separated from agreements, the function of which is to formulate in more detail additional obligations and rights pertaining to the investment.

. Some writers have portrayed the developments of the last decade as an advance from "concession" to "joint venture" to "service" (technical assistance/management) agreements, implying that the foreign investor at first admits host state participation (joint venture) and finally renders services as a subordinate "contractor" to the state mining enterprise. It is true that some state enterprises have acquired full ownership and concluded service agreements in petroleum and in a few cases in non-fuel minerals. A comparative analysis of the various types of agreement has found that, from a financial viewpoint, the form of the agreement is of little importance and that states often may have even lost revenues through the innovative arrangements advocated in the 1970s. Some countries have come to the conclusion that the emphasis on extensive ownership has led to a drain on their revenues, and, pushed by their treasuries, they are at present looking for ways to re-attract private capital to assume the risk of mineral investment. Also, countries have discovered that effective control over mining investment can be achieved by suitable economic and administrative policies and institutions in a less costly and risky way than by full-fledged government ownership. One solution practised has been to have the investor manage the operations under a symbolic supervision and require him to organize financing and assume the risk, but to arrange this de facto investment under the label of a service contract.

. The present attitude of companies must seem paradoxical to anyone who regards the movement towards service contracts as a movement towards greater host state control: Companies in recent projects often clearly prefer to act as suppliers of services and equipment, as managers of the project and eventually as long-term purchasers of output, but have been unwilling to contribute risk capital of their own.

Obligations of the company to gradually relinquish exclusive exploration areas, to carry out mutually agreed-upon work programmes and to undertake minimum expenditures, to post performance bonds, to serve earliest notice of discovery and finally to submit an adequate feasibility study are by now standard contract clauses and are being transferred into the general mining law. One issue is often debated in negotiations: Under what conditions must the company, after discovery, either develop the deposit or abandon its mining rights? Governments naturally want discovered deposits to be developed as soon as possible, while companies prefer to make a decision based on their own mine development, financing, marketing and mineral reserves policy. Modern agreements often provide for a review of the feasibility study by independent experts. Should the conclusion be reached that the deposit can be developed on a commercial basis (i.e. produce the rate of return usual in the industry), then the position of a company which is unwilling to develop the deposit weakens. Either it must develop the mine or lose its mining titles or be obliged to transfer all or part of its rights to another company which is willing to assume the investment. Sometimes, a waiting period (eventually combined with a waiting fee calculated as a royalty on possible production) allows the company to hold on to the mining right for a longer period. If the mining rights are transferred to another company which is willing to invest, compensation is often granted to the discoverer. Such compensation can be on the basis of previous exploration expenditures (eventually adjusted by an inflation or interest index), on the basis of a share in the operating company, on the basis of a production royalty or a combined mechanism.

. Modern contracts (concession, joint venture or service contracts) take account of the fact that ownership does not automatically confer control and that the function of management can be separated from ownership. While government equity is frequent, sometimes exceeds 50% or even reaches (in the case of service contracts) 100%, management is often entrusted to the foreign partner. This organizational set-up seems to be a reflection of the fact that mining companies and international financing institutions are unwilling to contribute capital if they are not assured that an experienced mining company will be in charge of operations. Banks, in particular, insist on strict

completion guarantees from experienced operators. Far-reaching management powers can be embodied in separate management agreements, in the conditions of a "contract of work" (e.g. the 1981 Indonesian contracts), in the articles of association of joint venture companies or in the organizational set-up of contractual joint ventures and service agreements. The real role of Government becomes clear in the degree of supervision exercised over management.

Sometimes joint technical committees are set up (in cases of non-corporate joint ventures) to consult, to supervise, sometimes to make policy decisions and to approve major issues submitted by management. In cases of corporate joint ventures, the board of directors has the potential of becoming an effective decision-making organ. Requirements of unanimity make the question of which party has majority largely theoretical. The real weight of such representation in supervisory or decision-making organs depends on the commitment and ability of government representatives and on the procedures of decision-making. While some Governments delegate political appointees, others delegate technical experts or at least provide for a technical group to advise board members.

III) Fiscal Regimes for Mineral Development

. In considering and in negotiating the various fiscal instruments, it is useful to view them as components of a single package, irrespective of their name, whether they are named taxes, export duties, royalties or free equity. The employment of the methods of negotiation and financial analysis enable negotiators to evaluate the impact and the interplay of the various fiscal levies. In some countries with no previous exposure to the mining industry, considerable efforts are necessary to co-ordinate the state agencies concerned - the Ministry of Mines, the Ministry of Finance, the Central Bank and others - to allow the formulation of a consistent and comprehensive government policy.

. Royalties, as a value-based charge on mineral production have not disappeared, as has often been predicted. They provide stabilized revenue, are a minimum charge for depletion of non-renewable resources and constitute in some mining countries the main source of revenue. Some countries have found that extensive royalty-like payments independent of profitability (export

taxes, sales taxes, artificial exchange rates) can erode the company's ability to reinvest and to maintain productivity. Also, development of marginal mines may be made uneconomical and high-grading may be encouraged. Mining of low-grade ores can upon determination by Governments, be subject to substantial royalty discounts; such discounts are also granted if operating expenses plus royalties exceed a specified amount. Governments following a policy of active investment promotion have granted royalty discounts for the initial years (to increase early cash flow, of considerable impact on discounted cash flow analysis) of commercial production and have recognized royalties in these years as payment towards future income taxes, thus reducing the tax burden, while retaining a stable source of income.

. Government participation in the form of equity has a considerable impact on rate-of-return calculations, in particular if the Government obtains equity free or at the time of mine development at its option on preferential terms ("carried interest"). The apparent financial benefit of a large free-equity percentage is often eroded in reality. Equity is never really "free" as it always requires a trade-off. In some cases this is arranged by keeping the original capital of the operating company small and raising the necessary capital either by cash contributions or by debt guarantees from all shareholders, including the Government. In other cases free equity is granted in exchange for mining rights, but provision is made for full reimbursement of the investor for previous exploration expenditures. A higher share of free government equity is regularly compensated for by a lower share of other levies, e.g. income taxes. In cases where the investor can obtain home country tax credit for income taxes paid, the host state will lose if it reduces taxes to compensate for higher free equity.

. Additional profits taxes (windfall taxes, resource rent taxes), triggered by income in excess of a stipulated rate of return, are frequently encountered in modern mining taxation and mining agreements. The common principle underlying the many complex formulas is that income exceeding a reasonable rate of return will be subject to additional government participation. This mechanism allows for considerable flexibility, as marginal and average

operations are not affected by prohibitive taxes, while in cases of highly profitable operations the state obtains an additional share, without having to request renegotiation of the agreement. The tax is, in general, triggered by a specified rate of return on total investment, not on equity investment. In practice, the investor's return can accordingly be much higher, depending on the debt/equity ratio, before it is subjected to the tax. However, this mechanism takes into account the investor's risk exposure by loan and completion guarantees and the provision by financing institutions for fast repayment of loans before the tax can start to operate. While this sophisticated system probably has the advantage of providing for greater flexibility and for reducing investment risks, it is also rather complex to handle. It may, hence, work best as an additional mechanism complementing a fully developed mining tax system.

. An indication of the impact of an unstable economic environment is the spread of indexation and other adaptation mechanisms. Cost control is important for host state administrations because companies have a natural interest in representing untaxed profits as cost reimbursements, in particular through affiliate transactions. As agreements with state enterprises rely increasingly on cost/plus reimbursement formulas, the more important cost control becomes. The standard procedure is to subject affiliate transactions to close scrutiny and measure them against the yardstick of market prices or at-arm's-length prices, where this is feasible. Another mechanism has been to disallow certain overhead expenses incurred abroad, or at least to set percentage limits on general overhead.

. Depletion allowances have been criticized in the last decade, but are still used in francophone African countries and have reappeared in Peru (1981). Some Governments favour the Canadian system of earned depletion allowances: companies are allowed to set aside a share of annual production value or profits (e.g. 10% of production or 25% of profits) or a percentage of exploration expenditures (Guyana 1982: 10% for five years, 5% thereafter) to be used for exploration. If within five years this exploration reserve fund is not used, full income taxes would apply, eventually on the

interest-adjusted reserve fund.

. Tax credit by the home country for taxes paid by the mining company to the developing country can become a major issue, in particular in the case of U.S.-based companies. Royalties and government participation generally do not qualify for tax credit; some Governments have therefore been able to obtain higher financial revenues from mineral development by trading equity for higher income tax shares. In particular, the formulation of additional profits taxes is often geared to obtaining tax credit in the home country, for example by imposing the tax on pre-tax income (which requires a considerably higher rate of return to trigger the tax).

. Tax stabilization clauses formerly restricted the Government's right to enact new taxes; their validity was questionable as they were meant to restrict national legislative sovereignty. Modern clauses are more subtle: they make the project fully subject to national law (including tax law), but provide that new fiscal levies affecting the financial equilibrium are to be compensated by a corresponding reduction of existing levies.

. The emergence of state enterprises is posing new problems for state tax policies. Many Governments which have nationalized petroleum and minerals production have seen their revenues decrease considerably and some have had to provide considerable financial support to keep state enterprises in operation (Indonesia, 1972-1975; Colombia, 1965-1975; Bolivia, 1951-1972; Ghana, from 1960; Mexico, 1982). As a result, many countries have started to require state enterprises to make payments to the treasury, sometimes through dividends to the state as a shareholder, sometimes by way of consolidation with the national income administered by the treasury. Some state enterprises are subject to the full range of taxes (Malaysia, Pakistan, non-fuel mining enterprises in Indonesia). In general, however, state enterprises enjoy privileged tax treatment on the theory that they are supposed to pursue wider objectives than merely profit maximization and therefore require corresponding tax compensation. Tax treatment of state mining enterprises is still an unexplored field, and both the actual amount of revenue obtained and the tax policies pursued require extensive study.

IV) DISPUTE SETTLEMENT AND RENEGOTIATION

. Nationalizations, frequent in the late 60s and early 70s, have been relatively rare as of late. In some recent cases, companies have left of their own volition, e.g. some U.S. petroleum companies in Libya. As many projects are incurring losses at present, a certain interest by parent companies in having the projects nationalized by the Government against compensation can be noted. While the issue of nationalization under international law is still being disputed, actual practice - as contrasted to legal claims - has relied predominantly on net book value, sometimes inflation adjusted. Payment is in practice generally made in hard currency, but often deferred, as in the case of government-guaranteed US\$ bonds. A characteristic feature of many compensation settlements is the continued presence of the nationalized investor, albeit in the role of a contractor supplying management, services and purchasing output. Such composite settlements often contain an additional element of compensation in the formulas used to calculate management, shipping and marketing fees.

. Renegotiation of existing agreements constitutes a more subtle and flexible way to adapt a relationship to change. While in times of bargaining strength host countries have resorted to this method of contract adaptation, companies also rely on this instrument if technical or economic circumstances seems to require a revision of existing agreements.

. A substantial renegotiation of existing long-term agreements is a reflection of fundamental changes in the economic environment affecting the equilibrium of an agreement. For example, the unexpected price increase of uranium in the 70s has resulted in renegotiation of most long-term, fixed-price sales agreements, with litigation over the issue of whether a multiplication of the uranium price constitutes "commercial impracticality" and hence a legitimate reason for renegotiation. Long-term contracts for the supply of bauxite, copper and iron ore between Australia and Japan have been renegotiated, affecting both the price and

the quantity of mine output to be delivered to Japan. Price renegotiation has also taken place in natural gas agreements; producer countries are relying on the price explosion in petroleum to justify a corresponding increase of natural gas prices. At present, due to energy price increases, a number of government-owned power enterprises locked into long-term, fixed-price contracts concluded in the 60s with aluminium smelters are requesting increases in power supply rates. Renegotiation is also an issue on the agenda if a pricing mechanism - for example, in long-term minerals sales contracts - are based on indexes the evolution of which no longer has any relationship to the cost structure of mining operations.

. When requesting renegotiation, Governments and enterprises rely on the legal principles of rebus sic stantibus (fundamental change in basic circumstances of a contract justifies a revision), while the defending party will insist on the "sanctity of contract". Also, investors will often point to "stabilization commitments" to protect the contract from adaptation. While the legal assessment of such arguments is difficult, actual practice demonstrates that renegotiation is a natural accommodation of partners in long-term business relations. Contractual practice in mineral development agreements, in long-term commodity contracts and in financing agreements has resulted in the formulation of ever more sophisticated mechanisms of periodic review, of automatic escalation and adaptation of contractual parameters in response to changing environmental conditions and external (cost, price, inflation) indexes.

. Arbitration is the prevalent mode to settle disputes which inevitably arise. Its function is, firstly, to motivate the parties to reach an agreement among themselves in order to avoid the intervention of third parties, and, secondly, to provide a neutral forum for settling disputes. Major petroleum producers have successfully insisted on the jurisdiction of their national courts. Similar policies are adhered to in most Latin American countries. In other developing countries, arbitration, either under the auspices of the International Chamber of Commerce (ICC) or the World Bank's International Centre for the Settlement of Investment Disputes (ICSID) is the rule. The United Nations General Assembly (in resolutions 31/198 of 1976 and 35/52 of 1980) recommended the use of the Arbitration and Conciliation rules of the United Nations Commission for

International Trade Law (UNCITRAL). While ICC and ICSID provide an institutional setting, UNCITRAL rules provide only procedural rules; it is up to the parties to agree on an authority to appoint the decisive third arbitrator in the event that the two arbitrators appointed by each side cannot reach an agreement. Some recent agreements provide an appointing authority for national or regional institutes or for institutions supposedly more familiar with developing countries. As recent arbitral proceedings demonstrate, this choice often determines the outcome of arbitration.

. The main recent cases of international arbitration dealing with the 1972 nationalization of petroleum companies in Libya and with the Jamaican production levy have been discussed. The Libyan cases have led to awards requiring restitution and compensation from Libya. Efforts to enforce these awards by seizing Libyan assets have failed in Switzerland, but were successful with American courts which held that Libya, by submitting to arbitration, had waived its sovereign immunity.

A recent arbitral award concerns a dispute between Kuwait and AMINOIL over the nationalization of a petroleum concession with a duration up to the year 2020. The arbitral tribunal recognized Kuwait's right to nationalize, subject to compensation. It held that even a stabilization clause could not prevent Kuwait from exercising its right to nationalization. In coming to that conclusion it relied on the theory expounded previously that the stabilization clause is but one of the many factors to be taken into account and balanced when the arbitrators are called upon to determine the compensation payable for legislative intervention into vested contractual rights. In determining the compensation payable, the arbitrators also held that it is the specific circumstances of the case, and not abstract general principles, which should govern the question of compensation payable. In particular, they relied on the concept that investors should at least be able to earn a reasonable rate of return on their investment. Instead of book value they used the depreciated replacement value (which takes into account inflation) and adjusted this value by a reasonable rate of return assumed to be 17.5% per annum up to the date of the arbitral award (i.e. not up to the date (2010) when the concession originally was to terminate. The award, as compared to previous

arbitral awards, distinguishes itself by a less rigid and more flexible approach, allowing the various factors raised in the international law debate to be recognized within a context of balancing based on the specific characteristics of the case at issue.

V) Three Recent Mineral Developments Agreements in South America

A) Background

Foreign investment has been a prominent and probably the major factor in bringing about the substantial mining industries of Chile, Peru, Bolivia (though here national entrepreneurs played a major role), Venezuela, Brasil and Guyana. On the other hand, economic nationalism and sentiment against foreign domination of vital national industries grew in the 1960ies, based on earlier antecedents and most major mining projects were transferred into state ownership, operated through state mining enterprises (CODELCO; MINERO-PERU/CENTROMIN; COMIBOL, since 1952; Hierro-PERU; GUY-BAU/BIDCO:....) from 1969-1975. New investment during that time was not actively encouraged and was subject to the relatively restrictive conditions of the investment regulations of the Andean-Pact (in particular Decision 24), grouping Chile (at that time), Bolivia, Peru, Ecuador, Venezuela and Colombia. The idea that emerged during that time was that mineral resources were to be developed exclusively by national (public or private) enterprises and that essential foreign inputs had to be acquired "depackaged", i.e. as separate purchases of equipment and technical assistance services. The mining laws of that period - notably the 1970 General Mining Law of Peru, fell in line with this emphasis on national mining investment.

This situation has been evolving, starting from 1975 and picking up considerable speed as a consequence of the worldwide economic recession 1980-1982 which has hit in particular the mining industries. Many projects that were considered viable in 1970 were not developed, as was expected originally, by the new state enterprises, due to the lack of capital, managerial and technical abilities, problems with marketing and more recently by the impact of the recession and the consequent

long-term decline of metal prices. Governments have realized the difficulty of getting investment organized, be it through national or through foreign enterprises and that trade-offs between national control and active mineral development have to be faced. The evolution of governmental policies can be traced on the legislative scene: The 1981 Peruvian mining law, the 1982 mining law of Uruguay, the 1979/1980 mineral promotion laws of Argentina witness the gradual shifting of emphasis from restriction to promotion. The investment rules of the Andean Pact have been softened progressively through national regulation and are more or less irrelevant today to mining investment. Nationalizations or forced-upon renegotiations have not occurred in the last years and countries have gone great lengths - without too much success - to re-attract foreign investment, albeit on terms that have to accommodate the political sensitivities of the South American countries and the practical requirements of investors and financiers. Three contracts have been selected which reflect this accommodation between government and investor/financier in three South American countries, where mineral production plays, or is expected to play, a major role for the national economy. These contracts, as a rule, are accompanied by other agreements influenced by the model set; they reflect on one hand the particular situation, the attitudes and traditions of the individual countries, but also mark the shift in mineral investment policies that has taken place.

(1) Chile/ St. Joe Minerals of 1977 (El Indio)

The 1977 investment agreement between Chile and St. Joe Minerals is marked by the very dramatic historical relationship between Chile and foreign mining investors. In the history of Chile, one of the world's major copper producers, mining, in particular copper, has played a major role. Large scale copper mining was initiated and developed by US companies (in particular Kennecott and Anaconda), and the nationalization of Kennecott and Anaconda under the Allende government in July 1971 was a major event, both in internal Chilean politics and within the context of the wave of nationalizations concerning foreign-held mining and petroleum operations around that time (Cf. Theodore Moran, Copper in

Chile, 1974). The following military government maintained the new Chilean state mining companies (CODELCO and ENAMI), but it attempted to accelerate mineral development - the stronghold of the Chilean economy and its major foreign exchange and export earner - by promoting foreign private investment, thus reversing the nationalistic policies followed by the Allende, but also the preceding Frei government.

The new policy by the military government is expressed in Decreto-Ley No. 600 of 1974 which governs foreign investment in Chile. Decreto-Ley 600 has been (since 1977 modified) the legal instrument of paramount importance for regulation of investment in mining, in particular as up to the new mining law of 1982 there was no modern mining legislation governing the grant of mining concessions in Chile and as Chile has not concluded specific "mining agreements". The system used in Chile, under Decreto-Ley 600, was a "foreign investment agreement", negotiated with the Foreign Investment Committee, that govern the grant of a series of investment incentives and guarantees to the foreign investor. This approach is different from comparable investment legislation of the time - notably Decision 24 of the Andean Pact - that emphasize not incentives, but restrictions and obligations imposed on foreign investment (and it is not surprising that Chile left the Andean Pact shortly after passing its 1974 Foreign Investment Law). It is also different from mineral development/investment agreements, that generally combine obligations and performance requirements, including special mining taxes, with guarantees and some tax incentives. The Chilean investment law appears, on the other hand, rather similar to the investment laws and investment agreements that have been passed in a number of French-speaking African countries ("Convention d'établissement"). In principle, the law authorizes the government to grant to foreign investors a large number of guarantees, tax and related exemptions; these are embodied in the form of an "agreement" (instead of a simple administrative grant, probably to increase the expectation of stability). Most agreements concluded at the same period differ relatively little from each other. The 1974 investment law was not viewed uncritically by all members of the ruling group in Chile, in particularly insofar as it contained an element of discrimination in favor of foreign investors through the grant of rights

that were unavailable to national investors. Some of the most-far reaching privileges(e.g. the 30 years stabilization guarantee) were reduced in the 1977 modification of the law(Decreto-Ley 1748).

The main features of the Chilean foreign investment laws, to become operative through specific foreign investment agreements, are:

- maximum tax guarantees
- guarantees against future restrictions on repatriation of profits, capital, compensation
- accelerated depreciation
- loss carry-forward provisions
- foreign exchange privileges

In addition, the military government split up the operative and regulatory role of CODELCO and created(Decreto-Ley 1350) CODELCO as the state enterprise in charge of production and marketing of copper on one hand and the Gomision Chilena del Cobre(Decreto-Ley 1349 of 1976) to advise the government on copper policies and to regulate and supervise copper production companies on the other.(Cf. Carlos Fortin, The Copper Policy of the Pinochet Government)

Since 1975, Chile has concluded, under the 1974 foreign investment law, a number of agreements. In 1975, an agreement with Metallgesellschaft(reprinted in Vol. I, at p. 467 et. seq.) started the foreign investment in Chile's mineral resources("Toqui"). In 1977, agreements were concluded with Noranda(a 51/49% joint venture between Noranda and the Chilean state enterprise ENAMI to develop the Andacollo copper deposit), with Superior Oil/Falconbridge/McIntyre Mines(a 51/49% joint venture with the state enterprise CODELCO to develop the Quebrada Blanca copper deposit), with Foote Minerals(a Newmont Mining subsidiary), a 55/45% joint venture with the state development corporation CORFO to develop lithium in the Atacama desert, with Nippon Mining (to develop the Cerro Colorado copper deposit) and finally with Compania Minera San Jose, Inc. , a 100% controlled subsidiary of St Joe Minerals to develop the El Indio gold/copper deposit. In 1978, EXXON Minerals purchased the La Disputada copper mine from the state enterprise ENAMI and concluded a foreign investment

agreement; in 1979, ANACONDA concluded a foreign investment agreements for exploration and development of the Los Pelambres deposits. In 1982, Getty Oil and Utah International have signed an agreement authorising investment in copper mining up to 1.5 billion US \$. (La Escondida copper deposit).

As of 1983, Noranda had withdrawn from the Andacollo project, due to financing difficulties and was reimbursed for exploration expenditures. Nippon Mining abandoned the Cerro Colorado deposit. Metallgesellschaft withdrew from the Toqui project. The lithium project is going forward. EXXON has continued to invest in exploration. Anaconda has stopped work in Los Pelambres due to the high cost of the project. While under given low copper prices the commercial viability and therefore the development of these copper

projects is not clear, the El Indio project operated by St Joe Minerals is the only major successful case of mineral foreign investment in Chile, indeed it has been reported that among the major mining projects initiated in the 1970ies the El Indio mine was the only one that showed a good rate of return performance (Mikesell, Foreign Investment in Mining Projects, p. 230 et. seq.).

The El Indio deposit is located at about 4.000 m above sea level in the Chilean Andes. The deposit contains gold, silver and copper. It was exploited for decades on a small scale, until, in 1974 it attracted the attention of St Joe Minerals. St Joe purchased mining rights from private owners through Compania Minera San Jose; San Jose now owns 80.6% of El Indio, the rest belongs to private Chilean owners. Intensive exploration started in September 1976 and again in September 1977, after the investment agreement was signed in 1977. By 1978, the orebody had been delineated, with two kinds of ores: Direct shipping ores, 49.222 MT, with 345 gr/MT of gold, 145 gr/MT of silver and 2.60% of copper; and ores to be processed in the plant, 3.120, 616 MT, with 12 gr/MT of gold, 144 gr/MT silver, and 3.52% copper. In late 1978, the decision to develop the mine was taken. In late 1981, the first commercial shipments started. Operations for 1982 yielded sales of ca. 12.000 kg of gold, 19.900 kg of silver and 9.700 MT of copper. St Joe has reportedly spent over 214 million \$ in developing the deposit. (Cf. Mikesell, 1983, 234 and Mining Magazine, March 1982; Denis Acheson, Revista Mensaje, September 1983)).

(2) Colombia/EXXON Association Contract for Block B of Cerrejon Coal Project (1976)

After extensive, and ultimately fruitless, discussions between the Government and Peabody International to develop the coal deposit of Cerrejon, Block A- (Central Cerrejon), covering about 38.000 ha, the government granted in 1976 the mining rights to the state petroleum company (ECOPETROL). ECOPETROL put up the project for international bidding on the basis of a Contrato de Asociacion. EXXON was selected and established INTERCOR as its project subsidiary. The mining rights were subsequently transferred to CARBOCOL, a newly established state enterprise for coal development. After the conclusion of the agreement in 1976, intensive exploration took place resulting, in 1980, in the declaration of a commercial discovery. The investment decision was taken subsequently. By 1981, project development had started (e.g. roads, airstrip, - railway, port facilities, social-economic impact study). Total investment was estimated, in 1979, to reach more than US \$ 1.2 billion and is likely to be substantially higher. Commercial production is expected to start in 1984/1985, and to last for at least 23 years with annual production of 15 million tons. The project is one of the major coal development projects worldwide and the largest investment project in Colombia.

The legal framework for the mining activities in Colombia is constituted by the Mining Law No. 60 of 1967 and No. 20 of 1969 as amended by Decree No. 1275 of 1970 and Colombia's petroleum code. CARBOCOL obtained its mining rights under these laws. The investment agreement, embodied in the Contract of Association, required approval under applicable investment regulations (Cf. the authorization of the investment of August 12, 1976 reprinted as an annex to the agreement). Foreign exchange privileges (in particular the right to transfer proceeds obtained for the sale of INTERCOR's assets and INTERCOR's net profits) are granted under Resolution 23 of December 16 of 1976 of Colombia's National Council of Economic and Social Policy, CONPES (Cf. Annex).

(3) Guyana/COGEMA Uranium Development Agreement (1982)

Guyana, a South-American and at the same time Caribbean country, is an important producer of bauxite. Bauxite operations were taken over from 1972-1974 from foreign investors and have since been run by Guyanese state companies (GUY-BAU/BIDCO). In recent years, due to technical, financial and managerial problems, but also due to the economic recession and the erosion of Guyana's strong position as a producer of calcined bauxite, production and revenues has fallen considerably and foreign assistance has been sought to improve the performance of Guyanese bauxite mining operations. Apart from bauxite, there is a lively activity of small- and middle-scale miners extracting gold, mostly by dredging operations from placer deposits. Most of the gold is smuggled out, to avoid having to sell it to government authorities for overvalued Guyanese currency. Guyana has been trying for some years to diversify its mineral production by encouraging gold, manganese, petroleum and uranium development, primarily by foreign companies. As there are indications for interesting uranium deposits, talks were held around 1980 with Uranerzbergbau, a F.R. German uranium company which brought no result, due to different conceptions about revenue-sharing. In 1979, a non-exclusive prospecting license was granted to COGEMA, a subsidiary of CEA, the French government's nuclear power agency, for uranium prospection. Under the terms of the agreement relating to the prospecting license, COGEMA was entitled to prospect for 3 years for uranium; it could then apply for an exclusive exploration right under a contract to be negotiated. The prospecting agreement was rather ambiguous and it was not clear, what type of agreement was envisaged and what would happen in case of disagreement on the terms of such agreement.

Negotiations between Guyana (with the Ministry of Mines and Energy and the Guyana Geology and Mines Commission) continued through 1981 and 1982 and led to an agreement in February 1982. Both sides were pressed to accommodation: The Guyana government was anxious to obtain foreign investment and to demonstrate its acceptance by foreign mining companies; in addition, the exploration of

uranium was to be conducted in an area of Guyana that is claimed by Venezuela. Getting French state involvement was hence seen as an asset in Guyana's dispute with Venezuela. COGEMA, on the other hand, was interested to diversify its sources of supply of uranium for France's very energetic and far-reaching nuclear power programme, up to now mainly dependent on Gabon, Niger and Namibia. Subsidized by government, it was involved in a major strategy to open up new sources of supply, resulting in COGEMA exploration or participation in Zambia, Colombia, Australia, Indonesia, Canada and other countries.

Guyana was assisted by the United Nations and a consultant from the Commonwealth Secretariat and a recent uranium agreement with Tanzania with Uranerzbergbau played the role of setting an example. Subsequently, though the uranium price was falling dramatically and most forecasts predicted considerably oversupply for the future, COGEMA has been continuing exploration and spent about 20 million US \$(as of 1984) on the basis of the agreement. The agreement is based on the Guyana mining law (of British origin) and applicable tax legislation, but, as compared to Colombia and Chile, the Guyanese bargaining team had much more leeway to negotiate and was less constrained by applicable mining, investment, company, customs or tax regulations. The smaller size of Guyana and a tradition of British law might be factors that have encouraged such comparative flexibility.

B) Type of Contract

Different from the Colombian and Guyanese agreement, the 1977 Chile/St. Joe contract is an "investment agreement" exclusively between the state acting through its Investment Commission and St. Joe as investor applying for investment incentives and guarantees under the applicable investment legislation. Most issues otherwise regulated in mineral development agreements (joint venture; revenue-sharing, including special taxes, royalties, fees etc) between governments and state enterprises on one hand and foreign investors on the other hand are absent. This method reflects the Chilean policy of not imposing on foreign investors joint ventures with CODELCO, the

state mining enterprise and using the investment law primarily as a device to attract investment in non-CODELCO projects (often, as here, with private Chilean partners) by the issue of incentives and guarantees. While other issues are notably absent, the incentives and guarantees granted are ample, detailed and comprehensive, thus reflecting the concerns of investors over a repetition of the nationalizations under the previous government and methods by the new Chilean government to provide assurances against such anxieties.

The main issues of the negotiation with San Jose (and the other agreements, which are very similar) were the question of tax stabilization, depreciation/amortization rates, import duty exemptions, foreign exchange privileges, non-interference by government in marketing and production, other tax exemptions, debt/equity ratios, and arbitration issues. A major issue were the scope of foreign exchange privileges. The history of foreign investment in Latin America is fraught with difficulties under foreign exchange restrictions: Countries usually, particularly in times of foreign exchange crises, tend to appropriate all foreign exchange proceeds from mining projects, while foreign investors tend, naturally, to be able to retain foreign exchange proceeds to service debt, to repatriate profits and to protect the investment against nationalisation. In addition, exchange rates with an artificially high value for domestic currency were sometimes imposed resulting in the imposition of quasi-taxes on foreign investment. The foreign exchange privileges of the agreement have to be seen in light of such experiences. In particular, St. Joe may retain export proceeds abroad, open foreign currency accounts in Chile and have free access to foreign exchange for carrying out the investment. These privileges are meant to ensure that the investor may effectively service its debt and obtain profits in foreign exchange.

Another important issue was the exemption from taxes and the limitation for new taxes. Again, these guarantees and incentives were borne out of the experience of investors with new taxes and other quasi-fiscal levies (e.g. the Jamaican bauxite levy imposed in 1974) that disrupt the financial system agreed or assumed during the time of the investment decision. Renegotiation of

fiscal arrangements and imposition of new taxes, levies and other additional government participations of a fiscal character are a prominent feature of government/investor relationships in the 1970ies and St Joe and the other companies were insisting on getting as many and as comprehensive guarantees from Chile as was possible. Accordingly, the government promises that it will not levy taxes on the sale of assets by St Joe, possibly in reference to the Allende-government's claim for taxes on "excessive profits" to be deducted from compensation payable after the nationalisation of Kennecott and Anaconda in 1971. The essential promise relates to a maximum tax burden of 49.5% on earned income (Art. 4.16). Given that Chile does not use production-based royalties or similar levies (production levy; export taxes etc.) and combined with the promise of Chile not to impose any new taxes or comparable fiscal levies (Art. 4.17), this promise (including the corporate income, the dividend withholding and a housing tax) effectively restricts government taxation to ca. 50% of taxable income. In contrast, most other mineral producers (including Canada, Australia and South Africa) use, in addition to a general income tax, dividends withholding taxes and property taxes also production-based royalties (in copper between 1 and 5 % of the value of metal contained in ore) and recently a special mining taxes on additional (windfall/excessive) profits exceeding a stipulated rate of return on investment. The Chilean method of avoiding additional special mining taxes and of subjecting mining investment only to the generally applicable income taxes is certainly an incentive of considerable power. It is probably based on the philosophy prevailing in Chile at that time favoring effective incentives for an aggressive investment promotion policy.

The financial impact of these fiscal incentives is bolstered by accelerated depreciation of fixed assets and by a 5-year amortization of preproduction expenses. These provisions are frequent in modern mining agreements and some agreements concluded under the impact of double-digit inflation even adjust preproduction expenses by reference to an inflation or cost-of-capital index (E.g. the 1982 Guyana/COGEMA uranium contract). A five-years loss carry-forward (Art. 4.12) ensures that the provisions for accelerated depreciation/amortization will exercise the required impact on the investor's cash flow calculations.

Other fiscal exemptions relate to interest paid on foreign loans; this provision is aimed at attempts in some countries to levy a tax on foreign loans which make financing and financing charges a more substantial burden both for the investor and for the income-collecting tax authorities. St Joe is also granted an exemption from import duties, provided products of comparable quality are not available at comparable terms in Chile.

A salient feature of the agreement is the freezing of income tax and customs duty rates for the term of the agreement, i.e. for 30 years (Art. 4.16 and 4.24) and the guarantee that no additional taxes will be imposed in the future, except if St Joe opts for a subsequent, generally applicable tax system out of its own volition. This freezing clause (authorized by the 1974 act and reduced under the 1977 act to 10-years) is not very frequent, as it seems to tie down the state's sovereign power of taxation for an inordinately long period. Few countries would go so far as to oblige themselves and the following governments for such a long period; in a number of countries (e.g. Jamaica), courts have held that a government can not tie the hands of the following governments and arguments are raised to the effect that any provision to that effect is counter to the basic tenets of sovereignty and in contradiction to the principle of permanent sovereignty over natural resources. In fact, the recent arbitral award in *Kuweit v. AMINOIL* (Int'l Legal Materials, 51(1982) 976) attributes only a relative effect to a contractual stabilization clause and a previous award (*LIAMCO v. Libya*, *Revue de l'Arbitrage*, 1981, 132) recognizes the state's right to abrogate such stabilization clauses by nationalization with compensation. A close reading of the agreement, however, reveals that Chile may have reserved its right to abrogate the guarantees given, albeit under the condition of compensation for damages, as Art. 4.26 of the agreement provides for "payment of full and adequate compensation for any injury or damage to San Jose caused directly or indirectly thereby" (i.e. if the guarantees under the agreement are impaired, attenuated or abrogated). Presumably, Chile would not be able under international law to abrogate these provisions for compensation, even if it may be entitled to abrogate the guarantees mentioned above.

Another guarantee of considerable importance relates to the freedom of the investor to determine production and marketing policies, without interference from the government. Again, this clause (which is frequent in African "conventions d'etablissement") is borne out of the experience of mining companies with governments that impose minimum production targets, even in times of unprofitable operations (to maintain foreign exchange earnings or to maintain mining employment) and that require producing companies to sell below market prices to domestic consumers or in the framework of intergovernmental arrangements. In addition, St Joe's position is furthermore bolstered by the provision (another stabilization clause) that St Joe "shall have the right to sell and export subject to such laws and regulations as are in effect at the date of this Agreement". This provision recognizes the supervisory powers of the Comision Chilena del Cobre based on applicable law in 1977 (e.g. its right to check if sales to affiliated enterprises conform to world market conditions, cf. also Art. 4.15(a) and (b) of the agreement and Decreto-Ley 1349, Art. 18 concerning a state monopoly for sales, also Law No. 16.624, Art. 7, 8 and 9 concerning mandatory reserves for domestic consumption and the Rules of the Board of the Chilean Copper Commission on the Chilean Producer Price, fixed by the Board for the time being as the LME higher grade for copper)), but exempts St Joe from subsequent, and more intensive government intervention, such as for example the imposition of OPEC-style "posted prices".

The 1976 Colombia/EXXON Cerrejon coal agreement is a "Contract of Association". The Contrato de Asociacion has been used by ECOPETROL since 1959 for larger operations with foreign investors in petroleum. Up to 1980, 62 contracts of that type were signed. The contract of association constitutes basically a non-corporate joint venture whereby the Colombian state enterprise holds the mining right, the foreign partner assumes the risk of exploration and whereby both partners share both in project development expenditures and project revenues. It differs both from the form of the equity joint venture, used in Colombia for the 1970 Cerro Matoso nickel agreement and from operations contracts used by ECOMINAS to participate in smaller mining operations, principally concerning emeralds, managed and financed by private

mining companies. (Operations contracts basically mean that the state enterprises leases the area, viz. the mining rights, against financial participation based on the prospective, or , if ascertainable, real value of production) Other major projects (e.g. the Cerrejon Block A coal deposit) are operated directly by CARBOCOL on the basis of service and turnkey contracts with engineering companies.

The 1982 Guyana/Cogema uranium contract provides that in the event of commercial discovery and development a joint stock company will be set up. Different from Chile, where there is no state participation in the El Indio project, both Colombia and Guyana use a joint venture model. While the Colombian joint venture is a mere contractual joint venture, without any reliance on the models of company law, Guyana uses the joint stock company to constitute the form of cooperation. Both in Guyana and Colombia, as will be seen, the foreign partner assumes the role of the manager, with supervision and policy-making delegated to joint organs of cooperation. Thus, the system of a separate management contract (as in the 1976/1980 Panama Cerro Colorado agreements) is integrated into the organisation of the joint venture itself.

C) Organisation, Management and Control

While, true to its nature as an investment agreement, the Chile/St. Joe contract leaves corporate organisation to the private companies forming a joint venture, both Colombia and Guyana have established a delicate structure of management by the foreign company, while supervision and policy-making rests with joint organs. Carefully inserted checks and balances bring about the necessary compromise between the government's interest in control, participation and eventual full national control, and the companies' and investors' requirement of full management during the exploration and an extended part of the production phase.

In the Colombian case, the "Operator", i.e. INTERCOR, will be set up as an independent company and undertake construction according to a pre-established and agreed upon work programme. Expenses will be charged to a joint account. Three years are allotted for the construction period, with possibilities for an extension. The exploitation period starts with the first shipment of coal to seagoing vessels and lasts until the end of the contract's term (30 years). The parties have emphasized (Art. 31) that it is not envisaged to set up a jointly owned corporation or a partnership. Parties have no power of attorney for each other and no joint liability exists. However, contrary to such denials of corporate joint-ventureship, the 50/50 % participation in a joint, high-risk and long-term coal development project requires a quasi-corporate organization to allow the partners to achieve the necessary coordination and institutionalization of their community of interest. It is therefore interesting to observe how INTERCOR and CARBOCOL have constructed a non-corporate institutional network for joint project cooperation.

INTERCOR is to set a company as the "Operator", designated as the prime holder of management responsibilities and entitled to appoint the "Manager" of the joint project. The appointment of the "Manager" will require previous consultations with CARBOCOL. Operations will be subject to an "Executive Committee". The task of this committee will be to supervise construction and operations; evaluate the Operator's performance, approve work, investment and expenditure programmes; approve expenditures and contracts of a large scale, appoint auditors and supervise the management of the Joint Account. The Executive Committee consists of representatives of CARBOCOL and INTERCOR in equal number. Its decisions require unanimity. It is to meet four to five times a year and is empowered to establish sub-committees. The executive committee hence appears as the main body for organizing project cooperation. In case the unanimity rule prevents a decision, recourse will be had to the chief executives of both partners and eventually the contract's machinery for dispute settlement is to break a deadlock. This three-tiered process of decision-making may become rather heavy, but it can be expected that the expectation of long and protracted negotiations will motivate the partners on

the Executive Committee to seek a solution themselves, thereby avoiding the escalation to high-level consultations and ultimately arbitration and litigation.

The Executive Committee supervises the Operator; the Operator is free to appoint personnel, but has to comply with general guidelines of the Executive Committee.

The Joint Account is the main instrument to organize the financial relationship between the parties. The Joint Account is, according to the agreement, to be set up if commercially exploitable deposits are discovered. This provision reflects the risk-character of the agreement: The foreign partner is to bear the exploration risk, a full partnership with a sharing of costs, benefits and risks only takes effect, if the exploration resulted in commercially exploitable deposits. Through the joint account Colombia fully participates, if not in the exploration risk, in the risk related to the development of the mine and the marketing of the output. Also, it has to secure financing and thereby fully assume the risks of financing, e.g. increasing interests rates in spite of a possible shortfall in revenues and cost overruns. The Joint Account is characterized by the 50/50% distribution of expenses and benefits. All expenses are to be charged to the Joint Account. If a party is in default with respect to its mandatory contribution to the Joint Account the other party will receive interest at commercial rates on its positive position in the account. As expenses will be incurred in Colombian pesos and US dollars, special rules are provided for currency conversion. If CARBOCOL is in default with its obligations to contribute, INTERCOR can use its royalty payment obligations to cover the default and equalize the joint account positions of both parties.

In Guyana, the government's position is characterized by its inability, now and in the future, to contribute risk capital to uranium development. Guyana has been for quite some time in dire difficulties concerning availability of foreign exchange and is unlikely to find commercial financing. On the other hand, given its history of nationalizations and its professed state and

cooperative socialism, it was anxious to occupy the commanding heights of the mining venture. The compromise resulting is rather unique: Guyana obtains a 25% free equity in the project, protected also in case of capital increases and against any obligation to secure shareholders' loan guarantees. In addition, Guyana will nominate the majority on the board of directors, including the chairman, of the prospective joint operating company, irrespective of its 25% equity share. Finally, Guyana retains an option to acquire up to 51% , either when the joint operating company is set up at a price reflecting COGEMA's paid-up capital, or, if subsequently, at commercial rates assessed by independent valuers.

In exchange, COGEMA insisted that it retain full management powers and be protected by unanimity rules on the board of directors in all questions concerning major decisions. Additional checks and balances consist of a "Guyanization" of the positions of Chief Financial Controller, 5 years after commissioning of the mill, and General Manager, 10 years after commissioning of the mill; other control devices are a joint marketing committee to monitor marketing, in particular long-term sales contracts, a dispute-settlement method to determine in case of pricing disputes and elaborate rules on allowable expenditures. The Guyana contract is rather unique in the respect that COGEMA accepted Guyanese majority irrespective of Guyanese free or paid-up equity, but can be workable on the basis of the extensive management powers and unanimity requirements for COGEMA.

D) Financial Regime

In the Chile/St. Joe agreement, fiscal instruments are not so much established as incorporated from general tax legislation and frozen(cf. supra). The promise relates to a maximum tax burden of 49.5% on earned income(Art. 4.16). Given that Chile does not use production-based royalties or similar levies(production levy; export taxes etc.) and combined with the promise of Chile not to impose any new taxes or comparable fiscal levies(Art. 4.17), this promise (including the corporate income, the dividend withholding and a

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In the Colombia/EXXON agreement, the fiscal regime has to be seen in light of the fact that CARBOCOL, the Colombian state enterprise, assumes 50% of project development expenditures, and thereby a heavy, and rather unusual financing burden for a state mining enterprise. The revenues of the Colombian state are generated by fiscal instruments and by the participation due to CARBOCOL as partner of the Association Contract. The Colombian state receives income primarily through regular income taxes (at 52%). A recent analysis (Stephen Zorn, Coal and Uranium Investment Agreements, Natural Resources Forum 6 (1982) at p. 350) is based on the assumption that, apart from "participation revenue" (Cf. infra) no income taxes are due; this reading of the contract ignores that Art. 16.4 and 30 of the agreement are based on the assumption

that regular income tax is paid under generally applicable income tax law. As the contract regulates only the INTERCOR /CARBOCOL cooperation, and as it does not constitute a modification, or waiver, of generally applicable legislation, the fact that the contract itself does not provide details on general income tax can in no way be used to assume that income tax is not payable. In Colombia, as in other countries with a strong legal tradition, the government can not waive or modify the applicability of general legislation except if expressly authorized by law to do so. This reading is confirmed by an analysis of the contract by the Colombian National Planning Department (1981, op.cit., at 2.2.1).

The second method of generating government income is through the three-tier revenue-sharing system between INTERCOR and CARBOCOL as partners of the contractual joint venture: CARBOCOL receives (1) royalties; (2) a share of the coal produced; (3) participation revenue, i.e. a kind of an additional tax on profits exceeding a basic rate of return on investment (Art. 13 et. seq.).

Coal production is shared between both partners at the rate of 50/50. In addition, INTERCOR has to provide to CARBOCOL a 15% royalty on its share. A part of the royalty is to go to provincial and municipal authorities under Colombian law. CARBOCOL may take the royalty either in cash or in kind. In both cases, the royalty is calculated on the mine-mouth value or volume, with transportation and storage charges for delivery to the export terminals to be accounted for separately.

A very interesting fiscal instrument is the "participation revenue" due to CARBOCOL. Basically, INTERCOR income (not including US \$-indexed depreciation) exceeding a rate of return of 35% on accumulated total investment is subject to the tax/participation mechanism at rates that rise progressively in proportion to the absolute amount of pre-tax (but after-royalty) income exceeding the 35% rate-of-return level (Cf. Art. 16.2 and Exhibit I, para .3). This mechanism has to be seen in the light of the fact that INTERCOR registered all of its capital contribution as equity investment so that there will be no deduction of interest on INTERCOR's capital contribution when calculating income

subject to taxation and the participation mechanism. An evaluation of the financial terms conducted for the Colombian National Planning Department (para. 2.2.1) comes to the conclusion that the participation mechanism, in terms of net present value, has a financial impact equivalent to additional royalties at a rate,, depending on the prices for thermal coal, between 2 and 7%. While agreeing in principle with the participation mechanism, the financial evaluation regards the threshold of a 35% rate of return for imposing the additional tax for excessively high, particularly when compared to an average rate of return of ca. 15% earned by US mining companies on equity investment. While a 35% threshold is indeed unusually high, one should not forget that, different from additional profit taxes imposed elsewhere (e.g. Guyana; Tanzania; Papua New Guinea), the Colombian participation mechanism is imposed on a total investment figure that is not adjusted by reference to an inflation index; hence, as inflation increases the nominal value of revenues, but not the nominal value of the investment base, the 35% target will be easier to reach. Also, the fact that INTERCOR does not deduct interest when calculating its revenues for tax purposes, increases revenues and hence makes it easier to reach the 35% threshold. Finally, while financial experts always emphasize that additional profits taxes should be calculated by using a rate of return on equity and not on total investment, it is very difficult to find in actual practice any contract or mineral tax regulation using that theoretical approach .

When considered as a whole, the financial regime of the contract based on a 57.5/42.5 (royalty already being taken into account) production-sharing, a 52% income tax and the participation mechanism imposed on pre-tax profits is more favorable than is claimed by commentators. When compared to more recent coal contracts (e.g. the 1981 agreements between Indonesia and US coal companies) with lower royalties, lower income taxes and without an additional profits tax, Colombia appears not to have made such a bad deal after all. Such evaluation holds true even if the fact is taken into account that Colombia (effected through the Joint Account, Art. 21) has to contribute 50% of the expenses for developing and operating the coal deposit; the investor has to assume exploration at his own risk (Art. 5) and is apparently not reimbursed

for exploration and other pre-production expenses (as is often done in exploration/development agreements) except by amortization of such pre-production expenditures to reduce the income-tax load. On the other hand, by sharing expenditures and production, CARBOCOL is certainly more heavily involved both in the commercial and technical risk - and the benefits - of the Cerrejon project than Indonesia in 1981, where the government's role is restricted to taxation without participation in the venture with its own risk capital.

In the Guyana/COGEMA agreement, the financial arrangements and the fiscal regime are based on the philosophy that Guyana should not be exposed to any foreign-exchange liabilities and that the fiscal regime should be flexible to the ups and downs of the volatile uranium market. Guyana obtains a 25% free equity, protected against increase of capital and requisite shareholders guarantees or loans. Guyana is only obliged to provide advances through goods, services and products or Cash in Guyana currency. A debt/equity ratio of 4:1 (in Chile: 85:15) is agreed upon.

Royalties are payable at a rate of 3% of the sales value of minerals. The rate will increase to 5 %, if the ratio of the total annual production costs including operating costs, interests, amortization, depreciation and the three percent royalty to the annual sales value is less than 85%. By this device, Guyana increases early cash-flow for the company and will obtain the higher royalty only at a later stage, when market conditions and operating costs allow it. COGEMA will pay income and corporation tax at a rate of 45% and obtains accelerated depreciation/amortization (5 x 20%), exemption from customs duties and a 7-years loss carry forward. The prospective joint company will be entitled to an exploration allowance for future exploration outside the mining area up to 10% of total capital expenditure in the first five years, and 5% thereafter. A "special mining royalty" is established which basically triggers an additional tax at a rate of 25% on income exceeding an internal rate of return on total investment of 10% plus either, at the company's option, the US inflation rate or the US domestic corporate borrowing

rate. Other methods of government revenue-sharing consist in a 15% withholding tax on dividends and the government's free 25% equity.

Foreign exchange rights are established to meet foreign exchange obligations and to pay amounts due to COGEMA; these rights are guaranteed by the Bank of Guyana.

E) Legal Status

In all three cases, the legal status of a contract between the government and a foreign company is difficult to ascertain, as South American countries (in particular Latin American countries) have always emphasized the Calvo doctrine fully subjecting such agreements to national law and jurisdiction. Investors, on the other hand, have tried to secure some protection from subsequent government interference by having access to international law and arbitral tribunals.

The Chile/St. Joe contracts provide several times for a stabilization ("freezing") of the law valid at the time of conclusion of the contract for the duration of the agreement. However, surprising given the investment promotion philosophy of Chile at that time, the agreement follows the Calvo-principles and omits any reference to international arbitration (e.g. ICSID, ICC or external ad-hoc arbitration, e.g. with UNCITRAL rules).

The Colombia/Exxon contract is exclusively subject to Colombian law and to the jurisdiction of Colombian courts; INTERCOR waives, consistent with the Calvo-doctrine, diplomatic protection except in the case of a narrowly defined denial of justice. Colombia follows thereby closely and successfully the Calvo-principles which have often been denounced by foreign companies as inimical to investment security. However, their impact in Colombia may be lessened and their acceptability by EXXON may be increased by the fact that Colombia has enjoyed an unusual legalistic tradition and independence of the judiciary which may make the unilateral change of contractual terms by way of

legislative action less likely than in other countries.

While the agreement does not provide for international arbitration on investment disputes, as generally preferred by foreign investors, it contains a special procedure for "technical disputes": They are to be submitted to a three-experts-panel; the chairman will be, if both parties can not agree, appointed by the Managing Board of the Colombian Association of Engineers, in the case of accounting disputes by the Central Board of the Bogota Accountants. If the qualification of a dispute as legal or technical is controversial, Colombian courts will decide. Non-technical disputes are exclusively within the jurisdiction of Colombian courts.

The concern of the investor for stability of essential terms of the agreement are evidenced by several clauses: Art. 16.4 seeks to stabilize the impact of future changes of the general income tax law in Colombia: While, true to the nature of the agreement creating a legal obligation only between INTERCOR and CARBOCOL, but not with the Colombian government as such, the article does not attempt to "freeze" the tax legislation applicable in 1976, but rather provides that the financial impact of a change of general income tax rules on INTERCOR will be off-set by a corresponding modification of the "participation revenue" due to CARBOCOL. In other words, CARBOCOL will have to reduce its claims against INTERCOR, if INTERCOR is taxed by the Colombian state more heavily than assumed in 1976. This method of stabilizing the fiscal regime is less questionable as traditional "freezing clauses" which were open to attack on the ground that a sovereign state can not tie its hands by contract with a private enterprise. However, the clause does not cover all contingencies: For example, one could envisage an increase or imposition of taxes on mineral production that exceed the amount payable under the participation mechanism. In that case, INTERCOR would be hard put to claim compensation from CARBOCOL.

Art. 39 declares the foreign exchange regime determined by the National Council of Economic and Social Policy (Cf. supra) one of the "basic conditions" for the contract and the agreement incorporates the full text of the pertinent

decision. The agreement does not provide for a procedure or sanction if that foreign exchange regime is modified. Presumably, INTERCOR would be entitled to claim breach of contract, terminate the agreement and ask for compensation.

The 1982 Guyana/Cogema uranium agreement also witnesses the difficult methods of accomodating national sovereignty versus investment stability concerns. Apart from a procedure of expert determination in case of pricing disputes for uranium exports, disputes will be subject to a conciliation procedure between the Minister and the Chief Executive of COGEMA. Otherwise, the Chief Executive of the Inter-American Development Bank may appoint a conciliator who can make a non-binding recommendation. Otherwise, there will be dispute settlement by arbitration on the basis of the UNCITRAL arbitration rules. The appointing authority will be the Secretary-General of the Commonwealth Secretariat or, the Secretary General of the International Court of Justice (presumably, the wording in the agreement is obsolete). Other technical disputes will be determined by experts using the ICSID's rules on fact-finding, to be appointed by the appointing authority for arbitration (cf. supra).

The agreement is declared to be governed by the law of Guyana; however, the terms of the agreement are stipulated to prevail over general law. Tax rules applicable during the time of the conclusion of the contract are frozen for the duration of the contract.

F) Conclusions

The three agreements analysed in more detail with respect to form of contract, management and control, financial regime and legal status of the contract illustrate the new mechanisms of contractual accomodation between governments and investors in the wake of the wave of foreign investment restriction and nationalizations of the early 1970ies. In all three cases, the economic nationalism is clearly present and the governments take pains, in differing degrees, to uphold national sovereignty; on the other hand, the governments equally take pains to accomodate concerns of the investor and financiers considered reasonable, legitimate and required by the specific nature of the

project. The specific situation of each country is strongly present: While Chile grants guarantees on all questions where previous mining investors have been severely affected by previous government actions, Colombia's relatively reduced indebtedness in 1976 made it more ready to assume 50% of the financing burden of the project. On the other hand, political sensitivities seem to have made the Colombian government shun full legal association with the foreign partner in the form of a joint venture company. Guyana's strong interest in obtaining uranium exploration in areas disputed with Venezuela made it willing to grant a large exclusive exploration right, while on the other hand the contract strongly emphasizes the importance of Guyana having a strong visible representation in any future uranium company emerging. Also, Guyana's foreign exchange problems are reflected in its unwillingness to expose itself to foreign exchange debt, while emphasizing financial revenues, though in a very flexible form responsive to investor needs for heavy initial cash flow. In toto, the three contracts illustrate that the developments of the 1970ies may have made it more challenging to achieve sophisticated mineral agreements, but that on the other hand there is, provided both sides share an interest in investment, ample room for developing stable, but flexible contractual mechanisms that might be able to accomodate the main concerns of both partners even in view of changes in the economic environment for quite some time.

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Much for the information relied upon in this report is based on advisory missions carried out since 1981 by the writer or by DTCD mineral development legislation consultants to Colombia, Guyana, Costa Rica, Honduras, Guatemala, Dominican Republic, Haiti, Bolivia, Surinam, Argentina (in South and Central America). The report expresses, however exclusively the personal opinion of the author.

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